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In the Supreme Court of the United States

OCTOBER TERM, 1990

VIRGINIA BANKSHARES, INC., ET AL., PETITIONERS,

v.

DORIS I. SANDBERG, ET AL., RESPONDENTS.

FIRST AMERICAN BANKSHARES, INC., ET AL., PETITIONERS,

v.

PAUL H. WEINSTEIN, ET AL., RESPONDENTS.

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY BRIEF FOR THE PETITIONERS

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REPLY BRIEF FOR THE PETITIONERS

Nothing in respondents' labored submission can obscure the fact that the court of appeals' judgment finds no support in federal proxy law and defies common sense. Petitioners, including the individual directors, have been ordered to pay damages of as much as $13,000,000 merely for stating that they recommended the merger because it afforded a "high price" to shareholders, even though the price unquestionably *was* high in the very sense used by the proxy statement—*i.e.*, "about 30% higher" than prior market price. Pet. App. 53a. They also have been subjected to damages for describing a prestigious investment banking firm, concededly unaffiliated with petitioners, as "independent." Worse yet, respondents have been allowed to recover millions of dollars in damages even though the jury did not find, and could not have found, that the proxy statement caused them any harm.

In our opening brief we demonstrated that the court of appeals was able to reach this startling result only by relying upon untenable theories of misrepresentation and causation. Not surprisingly, given these errors, *respondents do not defend the court of appeals' reasoning on either of the issues before the Court.* Instead, they have sought to reframe the case, grossly distorting the record in the process. For example, respondents have felt compelled to rewrite the proxy statement in order to make their misrepresentation claims seem plausible. And they have introduced a plethora of new factual contentions and theories of causation that never were presented to the jury. The problem with this strategy, of course, is that liability may be predicated only on the proxy statement that actually was issued—not the fictitious one that respondents have created—and only on causation allegations actually advanced at trial.

I. RESPONDENTS FAILED TO PROVE THAT THE PROXY STATEMENT CAUSED THEM ANY INJURY

The SEC is on common ground with us on one crucial point: the "judgment below was in error" (SEC Br. 29)

because the jury was allowed to award damages to respondents without finding that the proxy statement ever caused them any injury. Respondents attempt to avoid this fatal defect in two ways. First, they advance the spurious contention that the causation issue has been waived. Second, they fancifully assert that the votes of the minority shareholders were in fact critical to the transaction, either because a Virginia conflict-of-interest statute required minority shareholder approval or because FABI somehow conditioned the merger on their approval. Both of these contentions are untenable.

A. The Causation Issue Has Not Been Waived.

In a reprise of their brief in opposition to the petition, respondents contend (Br. 29-33) that the causation issue is not properly presented. By deciding to grant certiorari, however, this Court previously rejected that argument. See *Oklahoma City* v. *Tuttle*, 471 U.S. 808, 816 (1985); S. Ct. Rule 15. And it did so for good reason.

The causation argument was first raised at the summary judgment stage. The corporate defendants sought summary judgment on the ground that respondent Sandberg could not prove causation because FABI owned 85% of the voting shares.[1] Notwithstanding this argument, the district court declined to grant summary judgment and, in fact, effectively directed a verdict on causation by instructing the jury that it would be a "sufficient showing" of causation that the "proxy solicitation itself * * * was an essential link in the accomplishment of the transaction." J.A. 426. In the same vein, the court charged the

[1] The summary judgment brief demonstrated (J.A. 76) that "FABI and [VBI] owned more than sufficient shares to assure ratification of the merger, without putting the matter to the minority stockholders." The brief then noted (*ibid.*) that "*Mills* left open [the] issue presented in this case" and argued that the "rule [of *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974)] makes no sense, and it particularly makes no sense in this case." J.A. 77. That submission was incorporated by reference once again when the corporate defendants sought a directed verdict. J.A. 326.

jury that, in such circumstances, it would be "no defense that the votes of the minority stockholders were not needed to approve the transaction." J.A. 427.

These portions of the charge were based directly on respondent Sandberg's proposed instructions 29 and 30. Contrary to respondents' demonstrably inaccurate representations to this Court (Br. 30-31 & 38 n.42), both sets of defendants did object to these instructions. The director-defendants contended, for example, that the instructions were "contrary to the law and common sense, because any of the alleged misstatements * * * cannot have caused any damage to Sandberg."[2] Petitioners again objected to the instructions in a bench conference, arguing that "the court has wrongly, we believe, decided the issue of law left open by footnote 7 of the *Mills* decision." J.A. 435.[3] Given the explicit objections to these critical instructions, it is hardly responsible advocacy for respondents to continue to assert that the causation issue was not properly raised in the district court.[4]

It is also astonishing to read respondents' assertion (Br. 31-32) that the court of appeals did not pass on the question left open in *Mills*. The Fourth Circuit's opinion speaks for itself. After acknowledging that "*Mills* left open the question of 'whether causation could be shown where management controls a sufficient number of shares

[2] Objections of Director Defendants to Plaintiff's Proposed Jury Instructions at 7. The corporate defendants' written objection appears in Objections of FABI and VBI to Plaintiff's Proposed Jury Charges at 6.

[3] Respondents' assertion (Br. 31 n.31) that the directors may not rely upon the objection voiced during the bench conference is mistaken. Although the objection was announced by counsel for the corporate defendants, it was made on behalf of both sets of defendants, pursuant to the district court's previous order that "I will assume that each joins in the others' objections unless you tell me otherwise." J.A. 132.

[4] All of the defendants again raised the causation issue in their post-trial motions. See Mem. of Director Defendants in Support of their Motion for JNOV at 22; Br. in Support of Defendants FABI and VBI's Motion for JNOV at 4 (J.A. 529-530).

to approve the transaction without any votes from the minority,'" the court below proceeded to adopt the holding of *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), that "if the proxy statement contained material misrepresentations and was an essential link in the merger, § 14(a) liability may be established" without regard to voting power. Pet. App. 13a-14a.[5] Thus, the issue left unresolved in *Mills* was squarely presented by both sets of petitioners and was "very clearly considered, and decided, by the Court of Appeals." *St. Louis* v. *Praprotnik*, 485 U.S. 112, 120 (1988). It has not been waived.

B. Respondents Never Alleged Or Proved Any Causal Connection Between The Purported Defects In The Proxy Statement And The Consummation Of The Merger.

In our opening brief, we made two general arguments about the causation-related flaws in this case. First, we argued that the Court should hold that causation cannot be shown in a Section 14(a) damages action where the minority shareholders could not have affected the outcome of the vote. We continue to urge the Court to adopt this view, which is the only approach that is faithful to Section 14(a)'s focus on the *voting* process. Although the SEC has persuasively demonstrated that *it* should be allowed to bring enforcement actions against those who make misrepresentations in a proxy statement, it has not begun to justify allowing recovery of damages by shareholders who have suffered *no* injury to their voting rights. Whatever the continuing validity of *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), it should not be extended far beyond its moorings.

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[5] The court of appeals' detailed discussion of *Mills* and *Schlick* belies respondents' contention (Br. 31) that the court was merely referring to petitioners' concession that a proxy statement was "essential" to the consummation of the merger. In any event, petitioners conceded only that a proxy statement was required by law. The proper causation inquiry, however, looks not to whether the *proxy statement* was necessary but to whether the *approval of the minority shareholders* was an essential link in the merger.

We also argued that even if non-voting causation theories might be acceptable in some instances, causation surely was not found by the jury in this case. The SEC agrees with this contention, concluding that the court of appeals' "analysis was incorrect" (SEC Br. 27) and that its judgment "cannot stand." SEC Br. 28. For their part, respondents no longer deny that they were obliged to prove causation under Section 14(a), and they have not defended the rulings of the lower courts that causation may be satisfied simply by showing that it was necessary under state law to issue a proxy solicitation. Instead, respondents assert that they *did* prove causation at trial, based on two different theories. These arguments were never presented to the jury, however, and in any event they lack any legal or factual basis.

1. *The "Conflict-Of-Interest" Theory.* On at least a dozen separate occasions, respondents proclaim that the votes of the minority shareholders were critical to the merger because "Beddow's divided loyalties * * * made the merger voidable, or subject to suit for restitution * * * unless the actions of the Bank's board were approved by the minority stockholders." Resp. Br. 3; see also *id.* at 9, 10, 11, 29, 34, 35, 36, 40, 42, 43, 44. Respondents rely on a Virginia statute that allows a corporation (not an individual shareholder) to avoid a transaction involving a director with a conflict of interest unless *either* the board of directors ratifies the transaction, *or* the shareholders ratify it, *or* the transaction was fair to the corporation. Va. Code Ann. § 13.1-691. There are three insurmountable problems with respondents' reliance on this statute: (1) respondents have never before alleged that the statute is relevant to their showing of causation, and the jury was specifically instructed that minority shareholders' votes were of *no* significance in assessing causation; (2) the Virginia statute in fact did not make the votes of the minority shareholders necessary to the merger here; and (3) the argument relies on a "sue facts" theory of non-voting causation that is inconsistent with Section 14(a) and with this Court's deci-

sion in *Santa Fe Industries* v. *Green*, 430 U.S. 462 (1977).

The dispositive answer to respondents' belated attempt to show causation in this case is that they had a duty to prove causation to a properly instructed *jury*—not to concoct new theories in this Court that did not form the basis of the judgment under review. This is especially true where, as here, the issue of causation was effectively taken away from the jury by instructions such as the following:

> • "[A] shareholder such as Ms. Sandberg has made a sufficient showing of a causal relation between the violation and the injury for which she seeks redress if she proves that the proxy solicitation itself rather than the particular defect in the solicitation material was an essential link in the accomplishment of the transaction." J.A. 426.
>
> • "If you find that it was necessary for the bank to solicit proxies from minority shareholders in order to proceed with the merger, you may find that the proxy solicitation was an essential link in the accomplishment of the transaction." J.A. 426.
>
> • "If you find that * * * the proxy solicitation itself was an essential link in the accomplishment of the merger transaction, then you are instructed it is no defense that the votes of the minority stockholders were not needed to approve the transaction." J.A. 426-427.

As the SEC has explained (Br. 28), these instructions erroneously "permitted a finding of causation if the proxy solicitation was an 'essential link' in the accomplishment of the merger," without any showing that minority shareholders (by their votes or otherwise) were even a factor in the transaction.[6] It is clear, then, that

[6] Respondents are plainly wrong in suggesting (Br. 38-40) that the defects in the causation instructions could be cured by a boilerplate proximate cause instruction. It was respondents who asked for and received specific instructions that the jury need find only that the proxy solicitation was an essential link in order to find causation. Those instructions nullified any effect of the earlier general instruction regarding proximate cause. See *Francis* v. *Franklin*, 471 U.S. 307, 322 (1985).

respondents' new-found claim that the votes of minority shareholders were necessary to "eliminate[] the otherwise paralyzing effects of a director conflict of interest" (Resp. Br. 9) cannot rehabilitate the judgment below.

Beyond this, respondents' "conflict-of-interest" argument fails on its merits because the Virginia statute (which respondents selectively paraphrase but studiously avoid actually quoting) most assuredly did not make the minority shareholders' votes necessary for the effectuation of the merger. Rather, it was the approval of the transaction by the Bank's board of directors that immunized the merger from attack on any conflict-of-interest theory, under the first of the statute's three provisions. See Va. Code Ann. § 13.1-691(A)(1) (a corporate transaction is not voidable if "[t]he material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors and the board of directors or committee authorized, approved, or ratified the transaction").[7]

Respondents eventually acknowledge (Br. 43-44) that the Virginia conflict-of-interest statute does not generally require minority shareholder approval, but they claim (Br. 44 & n.50) that board approval was ineffective here because the board failed to exercise "independent judgment" with respect to the merger and "was falsely told that KBW had originated the $42 merger price when, in fact, it had not." These factual assertions are erroneous (see pages 18-19, *infra;* Pet. Br. 3-8), but

[7] Respondents have quoted materials relating to this point in a most deceptive fashion. Contrary to respondents' assertion (Br. 11, 44), the instruction that petitioners offered with respect to the state law fiduciary duty claim against defendant Beddow did not even remotely concede that minority shareholder approval was necessary to cure any conflict of interest. Rather, the proposed instruction did no more than paraphrase the statute's three alternatives for approval of a transaction. See J.A. 431. The Virginia statute is reproduced as an appendix to this brief.

they are, in any event, beside the point. The literal terms of the Virginia statute require only that the board be aware of the "material facts *of the transaction*" (emphasis added); it is apparent from the record (and respondents do not dispute) that the board knew the buy-out price and the other material terms of the merger agreement.[8] Not surprisingly, respondents fail to cite a single Virginia authority suggesting that the conflict-of-interest statute would void the merger in this situation.

Finally, it is important to recognize that respondents' "conflict-of-interest" argument is not really a theory of voting causation at all. Instead, it is a typical "sue facts" argument: respondents assert that the alleged misrepresentation in the proxy statement deprived them of an opportunity to bring a derivative action in order to rescind the merger transaction in state court. But this new allegation convincingly demonstrates why this Court should reject the "sue facts" theory of causation in Section 14(a) cases. For under this theory federal courts and juries applying federal proxy law not only would have to involve themselves in highly speculative applications of state corporations law (*e.g.*, would respondents have been able to satisfy the prerequisites for bringing a derivative action?), but would also have to determine whether a transaction was "fair to the corporation" within the meaning of state law. Va. Code Ann. § 13.1-691(A)(3). Surely, damages liability under Section 14(a) should not turn on guesses as to the nature of state law judicial remedies available to a shareholder. And involving the federal courts in the assessment of a transaction's "fairness" is flatly inconsistent with this Court's

[8] Ironically, the purpose of the Virginia statute is to *relax* the traditional common law rule and provide "a safe harbor for transactions between the corporation and one of its directors." The Virginia legislature fully recognized that "directors of majority-owned subsidiary corporations often find themselves faced with the necessity of considering transactions with the parent corporation." A. Goolsby, *Virginia Corporation Law & Practice* § 9.8 at 117. 119 (1990 Supp.).

admonition in *Santa Fe* that "the fairness of the terms of the transaction" is simply not a concern of federal securities law. 430 U.S. at 478.[9]

2. *The "Implied Condition" Theory.* Respondents' second theory of causation (Br. 45) is that FABI somehow conditioned its agreement to a merger on obtaining approval of the minority shareholders. This imaginative allegation suffers from the same flaws as respondents' "conflict-of-interest" theory: (1) it is a brand-new allegation that was never presented to the jury, which was instructed in a manner that dispensed with any need to find causation; (2) it has absolutely no foundation in the record or in fact; and (3) it relies on a "shame facts" theory of causation that has no basis in the language or purpose of Section 14(a).

Until the case reached this Court, respondents had never once suggested that FABI conditioned the transaction on the approval of minority shareholders. No such evidence was introduced at trial, nor, as we have explained (see page 6, *supra*), was the jury ever asked to find that causal link. Accordingly, even if the allegation had some factual basis, it could not cure respondents' failure to advance it at trial or the defect in the instructions that took the causation issue away from the jury.

In any event, respondents' new allegation is baseless. The evidence cited by respondents (Br. 45-46) shows only that FABI was interested in offering a price that was so high that "any reasonable shareholder will accept it." J.A. 99. There was *no* evidence, however, that once

[9] Respondents, of course, *did* sue in state court to upset the merger or obtain an appraisal, alleging—without success—numerous theories of fraud and breach of fiduciary duty. It is telling that they never asserted (either in state or federal court) the unsupported theory of statutory "voidability" now presented for the first time in this Court.

FABI decided on its price it would refuse to proceed with the merger if the minority shareholders chose not to accept it (*i.e.*, if they acted in a way that FABI considered unreasonable). The evidence showed that FABI planned to go forward with the merger regardless of minority shareholder dissatisfaction, as it had every right to do under state law. Pet. App. 37a. Why would FABI have defended against respondents' state court action unless it was prepared to go forward despite opposition by minority shareholders? Respondents' argument intentionally blurs the fundamental distinction between an understandable desire to please minority shareholders, if reasonably possible, and a commitment to condition a merger on the blessing of minority shareholders.

Moreover, here again the nature of respondents' argument reveals the deep flaws in any theory of non-voting causation under Section 14(a)—in this instance, "shame facts." Respondents would allow a jury to impose damages liability based on sheer speculation about whether a proxy issuer would have gone forward with an economically beneficial transaction in the face of some (how much?) negative reaction from minority shareholders. As we argued in our opening brief (at 44), this Court should not allow respondents to satisfy their burden of proving causation in this judge-made cause of action by relying upon such inherently speculative and conjectural assertions. Acceptance of respondents' arguments would violate Congress's express admonition that damages under the federal securities laws be limited to "actual damages on account of the act complained of." 15 U.S.C. § 78bb(a). Because respondents did not and could not prove that any defects in the proxy statement caused them harm, the judgment below "cannot stand." SEC Br. 28.[10]

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[10] Entry of judgment for petitioners, rather than a remand for a new trial, is the correct disposition here for a number of reasons. First, respondents utterly failed to meet their burden of proof on one of the critical elements of their case, having "[t]hroughout the lengthy history of this case" failed to produce any evidence of causation. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 215 (1976). "In these circumstances" it would be "inappropriate to remand the action for further proceedings," *ibid.*, since petitioners were entitled to a directed verdict or judgment notwithstanding the verdict. See also *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 490 (1977) (plaintiffs "did not prove any cognizable damages and have not offered any justification" for putting defendants through a new trial); *United States* v. *Generes*, 405 U.S. 93, 106 (1972) (refusing to remand for a new trial where the Court examined the record and found "nothing that would support a jury verdict * * * had the [correct] standard been embodied in the instructions"). Moreover, quite aside from the unfairness of putting petitioners through a second trial, it is obvious that a remand on the issue of causation would be futile. Even today, the theories that respondents advance are incurably deficient, whether or not the Court absolutely rejects the possibility of predicating causation on "sue facts" and "shame facts." See *Bigelow* v. *Virginia*, 421 U.S. 809, 827 (1975); *Haynes* v. *United States*, 390 U.S. 85, 101 (1968).

II. THE PROXY STATEMENT DID NOT CONTAIN ANY MATERIAL MISREPRESENTATIONS OF FACT

Four words suffice to answer virtually all of the arguments that respondents and the SEC have put forward in support of the allegations that the proxy statement contained material misrepresentations: *read the proxy statement.* For the most remarkable aspect of these arguments is their complete infidelity to what the proxy statement actually says. Once the proxy statement itself is considered, it becomes apparent that respondents' proxy fraud allegations are the product of a strained misconstruction of obviously truthful terminology.

A. The Directors' Reasons For Recommending The Transaction.

It is useful to begin by reminding this Court of what the jury was instructed and what the court of appeals held. The first statement at issue was that the board approved the merger because it was "fair" and "provides an opportunity for the Bank's public shareholders to

achieve a high value for their shares." Pet. App. 37a, 53a. The Fourth Circuit declared that this statement was materially misleading because "the jury was certainly justified in believing that the directors did not believe a merger at $42 per share was in the minority stockholders' interest but, rather, that they voted as they did for other reasons, *e.g.*, retaining their seats on the board." *Id.* at 15a. In so holding, the court of appeals rejected the prevailing view that a claim addressed to "the 'true' motivations of the directors * * * states no cause of action under the 1934 Act" (*Kas v. Financial General Bankshares, Inc.*, 796 F.2d 508, 513 (D.C. Cir. 1986)), particularly where, as here, the shareholders received detailed information enabling them to draw their own conclusions about the directors' motivations.

Significantly, respondents make no serious effort to defend the court of appeals' reasoning that federal proxy law allows a jury to inquire into directors' subjective motivations. Instead, they have devised a new "objective" theory of misrepresentation, contending (Br. 13-14; emphasis added) that the proxy statement misrepresented "an objective event—*formal* action by the board to approve the merger because it offered minority stockholders a high value." There are two glaring defects in this argument. First, this new "objective" theory bears no resemblance to the allegation that actually was presented to the jury. Second, the proxy statement cannot possibly be read to represent that the board "formally" adopted a list of reasons for the merger.

Respondents' revisionist view is that subjective motivation had nothing to do with the imposition of liability in this case. See Resp. Br. 8. But respondents told the jury that the proxy statement was false precisely because some of the directors "didn't think [the offer price] was a high value" (J.A. 406), and the jury was specifically instructed that respondents alleged that "high value * * * was not the reason for [the directors'] approval." J.A. 421. Most telling, the court of appeals understood respondents' claim to involve an attack on the directors'

subjective motivations. See Pet. App. 15a. Although respondents may now regret their litigation strategy, a brief in the Supreme Court is not the place to introduce new theories of liability.

It is easy to understand why respondents' "formal board resolution" theory was not advanced at trial: it lacks any connection to what the proxy statement actually said. The only formal resolution described in the proxy statement is as follows: "[a]t the February 12, 1987 [board] meeting * * *, all directors present unanimously recommended that shareholders vote in favor of approval of the Plan of Merger." Pet. App. 53a. There is no dispute that such a resolution was unanimously adopted by the board. J.A. 458-460, 466. The proxy statement does not even remotely suggest that the board voted to issue a formal proclamation that the price was "high."

The proxy statement instead speaks of what the board "believes," "considered," "evaluated," and was "aware of." Pet. App. 37a-38a, 53a-54a. None of these terms implies a formal vote on each factor that was deemed relevant to the merger. Moreover, uncontroverted record evidence supported the representation in the proxy statement that the directors considered the fairness of the $42 offer and the $10 premium over market price. J.A. 234, 239, 257, 273, 279, 283; Pet. Br. 5-8 (citing record evidence). A board certainly can consider and evaluate such factors without taking what respondents characterize as "formal action" (Resp. Br. 14) evidencing that consideration. All of this is ultimately quite academic, of course, because respondents' "objective" theory of misrepresentation was *never presented to the jury.*

The SEC, by contrast, continues to focus on the allegation that the proxy statement misrepresented the true subjective motivations of the directors, arguing (Br. 17) that the jury could have found that the proxy statement was false "because the board approved the merger for other than *its stated reason*" (emphasis added). The problem with this argument is that it misreads the plain

language of the proxy statement to say that the *sole* reason for the directors' recommendation was their belief that a high price was being offered for minority shares.

The proxy statement unambiguously declared that the board's recommendation of the merger was "based upon its evaluation of a *number of factors*, including those set forth below." Pet. App. 53a (emphasis added). As for the factors that were considered, the proxy statement explained that "[t]*he principal purpose of the Merger is to achieve organizational efficiencies* resulting from the Bank's becoming a wholly-owned subsidiary of Virginia Bankshares." *Ibid.*; see also Pet. App. 38a. The proxy statement then described the premium for shareholders, which was an additional factor supporting the merger (*id.* at 53a-54a):

> The Plan of Merger has been approved by the Board of Directors because it provides an opportunity for the Bank's public shareholders to achieve a high value for their shares. The price to be paid is about 30% higher than the $32.50 per share at which the Bank's common stock traded on February 8, 1987, the last trading day prior to announcement of the proposal.

Nothing in this passage even remotely suggests that the *sole* reason for the board's recommendation was its assessment that a high value was being offered for the shares. To the contrary, the proxy statement explicitly referred to "a number of factors" and stated that the "principal purpose" of the merger was to improve the bank's efficiencies. Pet. App. 53a. Only by rewriting the proxy statement can the SEC attack it as false.

This same refusal to look at the words actually used in the proxy statement pervades the Fourth Circuit's discussion of this purported misrepresentation. The court of appeals ruled that the jury could have found that the directors were "considerably less concerned with the stockholders' interests than with their own." Pet. App. 15a. But this speculation does nothing to call into question the accuracy of the representation in the proxy statement that a payment of $10 above market price was "high" (*i.e.* "about 30% higher" than prior market price) and that this premium for the minority shareholders was *one* of the factors that persuaded the board to recommend the merger. No matter what *else* may have influenced their decision, it is absurd to suppose that the directors failed to recognize and give weight to the fact that the buy-out price was 30% higher than prior market price—a premium that was all the more striking because the acquiring party already owned a controlling interest. J.A. 342-344. Who could have failed to consider and attach significance to that unmistakable premium over market value? Certainly not directors who themselves held substantial amounts of minority stock.

It is apparent, then, that the "high value" passage of the proxy statement can be deemed false only if one is willing to indulge in the ludicrous assumption that the directors never even considered the premium being offered for the shares as *one* of "a number of factors" (Pet. App. 53a) supporting the merger. According to the SEC, however, the federal securities laws invite just such an inquiry into the directors' minds and allow juries to psychoanalyze the directors to determine their true mix of motivations.[11] That position is directly contrary to a long line of appellate decisions that have limited proxy fraud liability to misstatements of verifiable, objective facts—facts that the issuer of a proxy statement can readily ascertain and that a jury can fairly judge. See Pet. Br. 31-33.[12]

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[11] The SEC never explains how an inquiry into motivation would proceed in the case of a 22-member board of directors. Must the plaintiff prove that all of the directors—or just a majority, or just one—harbored some unspoken motivation? In this case, for example, the record contains no evidence at all concerning the motivations of seven of the directors who were held liable for millions of dollars in damages.

[12] The SEC suggests (Br. 10-11) that statements of reasons, or statements that a transaction is fair, are required in a variety of proxy statements. To the extent this is true, it highlights the need

Even if there were situations in which it might be appropriate to allow a jury to probe into the sincerity of directors, this is not such a case. The SEC purports to recognize the dangers of unwarranted speculation (Br. 12), but it never applies that policy to this record. Instead, the SEC urges the Court to find a proxy misrepresentation here even though there was *no* evidence suggesting that the directors failed to recognize that the merger "offered the minority stockholders an opportunity to receive a high value for their shares" (Pet. App. 15a) and even though a finding of misrepresentation is inherently implausible and is inconsistent with the following objective—and uncontested—facts:

- The reason given by the proxy statement comported with economic reality. The merger price *was* high in the very sense used in the proxy statement—*i.e.*, it reflected a 30% premium over market price. See Pet. App. 60a-66a.

- The reason given by the proxy statement comported with the contemporaneous discussions of the directors. See Pet. Br. 5-8.[13]

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for this Court to set limits on directors' vulnerability to attack. For under the SEC's theory, an action under Section 14(a) may be commenced by any shareholder who alleges that the directors really harbored some ulterior motive or who disagrees with the directors' assessment of fairness. That is precisely the kind of vexatious securities litigation that the Court has sought to avoid. What is more, if the SEC is allowed to (a) require statements of fairness and then (b) subject those statements to scrutiny under federal law based on a "misrepresentation" theory, it will have been allowed to evade this Court's clear holding in *Santa Fe* that the "fairness" of corporate transactions is a concern of state—not federal—law.

[13] Two of the directors acknowledged the obvious—that FABI, in its capacity as holder of 85% of the shares, had power under state law to replace them. But these directors also testified that they would not have recommended the merger had they not considered it fair to the minority shareholders. Sidney Dewberry, for example, who recognized that FABI "had the votes," also testified that "I clearly understood my obligations * * * [t]o see that the stockholder[s] got a fair price for their stock." J.A. 274-275. Similarly, Linda Michael recognized that FABI had the power to "get a board that would approve it," J.A. 282, but also testified that she understood that her duty was to see that the minority shareholders' "rights were respected in the price they were paid for their stock." J.A. 283-284.

- The directors had a strong incentive to consider the premium over market price, because *all* of them were minority shareholders. Indeed, one of the directors, who held more than $1.3 million of bank stock, testified that the price was "far more than generous." See J.A. 273.

Subjective motivations of directors should not be subjected to "judicial psychoanalysis" (SEC Br. 12) on a record such as this one. As this Court recently remarked in a related context, "implausible" factual allegations that make "no economic sense" should not be submitted to the jury, particularly where they rest on "ambiguous evidence." *Matsushita Electric Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 587, 593, 596 (1986).

B. The Evaluation By The Independent Investment Banking Firm.

Respondents and the SEC have an equally difficult time justifying the imposition of liability based upon the proxy statement's description of KBW, the independent investment banking firm hired by FABI. Again, it is critical to consider the actual words of the proxy statement in evaluating this claim. The alleged misrepresentation consisted entirely of the following: "FABI's Board of Directors commissioned Keefe, Bruyette & Woods, Inc., an independent investment banking firm, to pass on the fairness of the Merger from a financial point of view." Pet. App. 38a. This unremarkable statement was entirely true and accurate. Respondents and the SEC do not dispute that FABI hired KBW, that KBW *was* an independent investment banking firm, and that it *did* pass on the financial fairness of the merger—whatever state-law grievances respondents might have about the adequacy of its performance. See Pet. App. 74a-76a; J.A. 261, 339-363.

Because nothing in the literal language of the proxy statement falsely described the nature of KBW or its involvement in this transaction, respondents and the SEC have conjured up a fictional account of what the proxy statement says. For example, the SEC, after conceding (Br. 20) that the word "independent" accurately described KBW and that the judgment cannot stand if it was based on a challenge to that description, nonetheless argues that a reasonable reader of the proxy statement "could have formed the impression from the proxy statement that KBW had *originated* the $42 price per share." Br. 21 (emphasis in original). But the SEC never explains how it is possible to read the words "pass on the fairness of the Merger" to imply the notion of "originating" a price. Indeed, if anything, the words "pass on the fairness" suggest that KBW reviewed a price proposed by others. Certainly, they imply nothing about who originated the price. Like Humpty Dumpty, the SEC simply insists that language "means just what I choose it to mean—neither more nor less." [14]

Respondents offer yet another version of what the proxy statement might have been understood to say, but it is no more plausible. Based on testimony that Michael Connor of KBW was aware that Jack Beddow (who had no decision-making authority at FABI) was thinking about an offer in the $40 range, respondents assert (Br. 23-24) that KBW's evaluation of the price was not "independent" and was not carried out to "pass on the fairness" of the transaction.[15] Unfortunately for respondents,

[14] This Court has viewed similar submissions from the SEC with a healthy dose of skepticism. See, *e.g.*, *Dirks* v. *SEC*, 463 U.S. 646, 658 n.17 (1983); *Teamsters* v. *Daniel*, 439 U.S. 551, 567 & n.21 (1979); *SEC* v. *Sloan*, 436 U.S. 103, 116, 122-123 (1978); *Santa Fe Industries* v. *Green*, 430 U.S. at 473 n.12; *Piper* v. *Chris-Craft Industries*, 430 U.S. 1, 33, 39-42 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 214-216 n.33 (1976); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 746-747 n.10 (1975).

[15] Respondents blatantly distort Connor's testimony when they represent (Br. 24) that he disclaimed rendering an opinion that "pass[ed] on the fairness of" the $42 price to the minority shareholders. Connor in fact repeatedly testified that "even though we were working for the holding company, our charge was to come up with a price that the board of directors could reasonably view as fair, and at the $42 level, we were above the level that we would consider fair." J.A. 356; see also J.A. 341, 346, 347, 359 (FABI told Connor that "we want a transaction that is fair to the minority").

this misrepresentation theory confronts two impediments. First, it cannot be reconciled with the plain words of the proxy statement. The proxy statement described KBW as "independent"; it did not say, as respondents falsely paraphrase it (Resp. Br. 4, 25), that KBW conducted an "independent valuation" or an "independent analysis" of the stock. In fact, the proxy statement clearly and repeatedly disclosed that KBW obtained information relating to the issue of financial fairness directly from FABI and that it "did not attempt to verify independently any such information." Pet. App. 54a, 75a.

Second, respondents neglect to mention that Connor also testified, without contradiction, that it is entirely normal for KBW to be aware of the price range that a company is considering and that such knowledge has absolutely no effect on the integrity of its analysis or its fairness opinion. J.A. 261. Apparently, in respondents' view, no investment banking firm could ever be "independent," because due diligence (including discussions with the party that retained it) would be evidence of a lack of independence.

When all is said,[16] the misrepresentation claims advanced in this case, and adopted by the court of appeals, are profoundly disturbing. This case does not involve quibbles over debatable constructions of ambiguous language in a proxy statement. Rather, the representations made in the proxy statement were literally truthful in every respect; there were no "buried facts" (SEC Br. 11), and there is no suggestion that the language was

[16] It does respondents no good to list in their brief (at 26-29) various other claims of misrepresentation, none of which was sustained by the court of appeals and none of which pertains to the alleged misrepresentations that are before this Court.

used in the proxy statement in an unnatural manner. See *Backman* v. *Polaroid Corp.*, No. 89-1171 (1st Cir. Aug. 2, 1990) (en banc), slip. op. 22 (overturning a jury verdict where a "simple statement" challenged by plaintiffs under the securities laws "was precisely correct"). The question thus becomes whether it was "within the province of the jury," as respondents submit (Br. 25), to take that straightforward language and read into it unexpressed meanings and implications, and to indulge in far-fetched speculations about the subjective beliefs of 22 corporate directors, in order to convert it from a literally true statement into a fraudulent misrepresentation. No issuer of a proxy statement could comply with such an erratic and unprincipled regime. Congress, in enacting Section 14(a), did not create that system of proxy regulation, and the federal courts should not do so by judicial implication.[17]

CONCLUSION

The decision of the court of appeals should be reversed, with directions to enter judgment in petitioners' favor on the federal securities law claims.

[17] Respondents suggest (Br. 48 n.54) that if the Court reverses the judgment below on the misrepresentation issue it should remand the case to allow the court of appeals to consider other claims of misrepresentation in the proxy statement. If the Court does remand for that purpose, it should also make clear that the court of appeals is free to reconsider the judgment sustained against the directors on the state-law count, given the substantial interrelation of the federal and state charges in this case. See J.A. 45-52, 430-431, 405-409 (respondent Sandberg's closing argument); see also Pet. 27-30.

Respectfully submitted.

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APPENDIX

Virginia Code Ann. § 13.1-691 provides in pertinent part as follows:

> *Director conflict of interests.*—A. A conflict of interests transaction is a transaction with the corporation in which a director of the corporation has a direct or indirect personal interest. A conflict of interests transaction is not voidable by the corporation solely because of the director's interest in the transaction if any one of the following is true:
>
> 1. The material facts of the transaction and the director's interest were disclosed or known to the board of directors or a committee of the board of directors and the board of directors or committee authorized, approved, or ratified the transaction;
>
> 2. The material facts of the transaction and the director's interest were disclosed to the shareholders entitled to vote and they authorized, approved, or ratified the transaction; or
>
> 3. The transaction was fair to the corporation.